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In the Supreme Court of the United States

OCTOBER TERM, 1946

LILLIAN JEFFRIES, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

**ON PETITION FOR A WRIT OF HABEAS CORPUS TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH
CIRCUIT**

BRIEF FOR THE RESPONDENT IN OPPOSITION

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In the Supreme Court of the United States

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No. 1000

LILLIAN JEFFRIES, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

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STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH
CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 16-28) and its dissenting opinion (R. 28-29) are reported at 5 T. C. 1338. The opinion of the Circuit Court of Appeals (R. 39-42) is reported at 158 F. 2d 225.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on November 22, 1946. (R. 42.) A petition for rehearing (R. 43-55) was denied on December 24, 1946 (R. 56). The petition for a writ of certiorari was filed on February 10, 1947.

The jurisdiction of this court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a distribution in 1940 of corporate assets to taxpayer in complete cancellation of one-half of the corporation's stock was a distribution in partial liquidation, as defined in Section 115 (i) of the Internal Revenue Code, with the result that the gain on the distribution was includible in taxpayer's income in its entirety under Section 115 (c) of the Code.

STATUTE AND REGULATIONS INVOLVED

The applicable statute and Regulations are printed in the Appendix, *infra*, pp. 15-18.

STATEMENT

The facts found by the Tax Court (R. 17-25) may be summarized as follows:

The Girard Realty Company (hereinafter referred to as "corporation") was organized to own and sell lands in the Everglades section of Florida. Prior to 1932 its 25 shares of common stock were owned equally by taxpayer's husband, J. B. Jeffries, and by William H. Austin. In 1932 Austin died and his estate, which was administered in Pennsylvania, succeeded to the 12½ shares owned by him. (R. 18.)

In 1936 Jeffries died and in 1937 the taxpayer acquired the 12½ shares of stock formerly owned

by him. Both the taxpayer and the Commissioner have accepted \$2,750 as her basis for computing gain or loss on disposition of the stock. (R. 18.)

From 1936 to 1940, the assets of the corporation consisted of undeveloped lands which were held for sale, but none of which were sold during this period, although 55,000 acres had been disposed of prior to 1932. Some rent was received during the period but it was not sufficient to pay taxes on the land. (R. 18.)

After 1937 taxpayer was president of the corporation and manager of its affairs. The Austin estate did not maintain representation on the board of directors or among its officers. Prior to 1940, taxpayer asked for contribution from the Austin estate to pay accumulated taxes against the lands which the corporation had no funds to pay, but the estate refused to contribute. Taxpayer then advanced the money to pay the taxes and took mortgages on the corporation's property to secure the amounts advanced. (R. 18-19.)

On January 24, 1940, the taxpayer filed a suit to foreclose the mortgages and on February 5, 1940, a decree *pro confesso* was entered against the corporation. On the same day the Austin estate and heirs petitioned for, and on February 19, 1940, were granted, leave to intervene, and the decree was vacated. Among other things, the Austin estate alleged in its answer that the taxpayer had been guilty of fraud and that the mortgages were not valid. It requested that an

accounting be had and that a receiver be appointed to manage and control the corporate affairs for the purposes of liquidating the assets of the corporation, paying its indebtedness, and protecting the interests of stockholders. (R. 19.)

Thereafter, negotiations for settlement of the litigation were entered into by taxpayer and the Austin estate, and on March 27, 1940, they signed an agreement settling the issues. The agreement provided for sale of some lands to raise funds to pay expenses of the litigation and the amount advanced by taxpayer for payment of taxes; recited that it was desirable to effect a fair division of the remaining lands of the corporation among the stockholders; and that the parties would attempt to arrive at an agreed plan for a fair division before settlement day. As originally drafted the agreement provided for complete liquidation of the corporation, but representatives of the Austin estate redrafted it, inserting a provision that the corporation should not be liquidated completely or dissolved; that the lands allocated to the Austin estate should not be transferred to it, except as it requested; but that this did not qualify or limit the right of taxpayer to have distributed the lands allocated to her upon surrender to the corporation of the stock held by her. (R. 19-20.)

The taxpayer at first refused to sign the agreement as redrafted, because she understood that there was to be a complete dissolution of the cor-

poration. Upon being assured by attorneys and an income tax advisor that the retention of the corporation by the Austin estate would not affect her legal or income tax status, she executed the agreement. (R. 20-21.)

The corporation was not a party to the negotiations between the taxpayer and the Austin estate for the division of its lands. The settlement was made by the stockholders as a division of the property to which the corporation held title and as a settlement of the foreclosure suit. On April 3, 1940, the foreclosure suit was dismissed by court order pursuant to stipulation. (R. 21.)

At a meeting of the board of directors of the corporation on April 4, 1940, resolutions confirming the settlement were adopted. The minutes set out an involved accounting, the effect of which was that taxpayer and the Austin estate each received \$12,951.69 in cash or property; the attorneys and auditors received \$12,201.62; taxpayer was reimbursed for advances aggregating \$22,181.27; and she received one-half of the remaining lands of the corporation, having a value of \$87,802. The Austin estate became entitled to receive the other half of the lands having approximately the same value. The title to the lands not transferred to taxpayer remained in the corporation. (R. 21-22.)

A resolution adopted at the meeting provided for the issuance to taxpayer of a warranty deed

to such lands of the corporation as she should direct, provided she delivered to the corporation a written statement from the Austin estate agreeing that the lands so demanded were a fair division of the corporation's lands. It was resolved that upon issuance of the deed taxpayer should surrender to the treasury of the corporation for cancellation the $12\frac{1}{2}$ shares of stock held by her, and the consideration for issuance of the deed was in exchange for the surrender and cancellation of the stock held by taxpayer. It was further resolved that the cash amounts of \$12,974.80 paid to taxpayer and to the Austin estate were determined to be a return of capital investment and in no sense to be considered a dividend out of profits. Finally it was resolved that the money payments and the issuance of the deed were determined to have been made for the purpose of liquidating and dividing the assets of the corporation. (R. 22-24.)

Taxpayer received a deed from the corporation for the portion of the property she was to receive under the agreement with the Austin estate and surrendered her $12\frac{1}{2}$ shares of stock to the corporation. (R. 24.)

In her income tax return for 1940 the taxpayer reported the gain on receipt of the property transferred to her as a long-term capital gain, 50 percent of which was taken into account in computing her net income. The Commissioner determined

that the gain resulted from a distribution in partial liquidation of the corporation, and that it was to be treated as a short-term capital gain, all of which was to be taken into account in computing net income. (R. 24-25.)

The Tax Court affirmed the Commissioner's determination (R. 25-28), four judges dissenting (R. 28-29).

The Circuit Court of Appeals affirmed the decision of the Tax Court, one judge dissenting (R. 39-42).

ARGUMENT

The judgment below is correct and is not in conflict with any decision. No other sufficient reason for issuing a writ of certiorari has been suggested by the taxpayer.

(1) The Tax Court's findings show that in 1940 the corporation distributed to the taxpayer certain of its lands in exchange for one-half of its entire stock which the taxpayer surrendered for cancellation. The remainder of the corporation's lands was not distributed and the one-half of the corporation's stock owned by the Austin estate was not surrendered for cancellation but continued to be held by the estate. (R. 22-24.) The distribution to the taxpayer by the corporation was one made "in complete cancellation or redemption of a part of its stock"; it thus fits exactly within the first part of the definition of "amounts distributed in partial liquidation" in Section 115 (i) of

the Internal Revenue Code (Appendix, *infra*)¹ and also within Section 19.115-5 (c) of Treasury Regulations 103 (Appendix, *infra*), which provides that a complete cancellation of a part of the corporate stock may be accomplished, *inter alia*, by the complete retirement of any part of the stock, whether or not *pro rata* among the stockholders. The court below therefore correctly decided that the distribution to the taxpayer was one in partial liquidation within the meaning of Section 115 (i).

Even if it were reasonable to infer from the Tax Court's findings, which it is not, that the distribution was intended to be in effect a complete liquidation as taxpayer contends (Pet. 13-16) rather than a partial liquidation, the lower court would not have been warranted in concluding that Section 115 (i) did not apply. The controlling fact is that the corporation did not cancel all of its stock but only a part of it. The settled construction of the first definition in Section 115 (i) is that it is complete in itself for tax purposes, that no limitations or additional criteria are to be supplied, and that it applies to corporate distributions falling precisely within its terms, even though there was no intent, as such, partly to liquidate the corporation. See *Stern v. Harrison*, 152 F. 2d

¹ The second part of the statutory definition is not involved here, since, as the Tax Court pointed out (R. 25), no previous or subsequent distributions in cancellation of stock appear to have been made, and hence the distribution to the taxpayer was not one of a series of distributions.

321 (C. C. A. 7th), certiorari denied, 327 U. S. 807; *Yankey v. Commissioner*, 151 F. 2d 650 (C. C. A. 10th); *Citizens & Southern Nat. Bank v. Commissioner*, 136 F. 2d 406 (C. C. A. 5th); *Dodd v. Commissioner*, 131 F. 2d 382 (C. C. A. 5th); *Malone v. Commissioner*, 128 F. 2d 967 (C. C. A. 5th); *Hill v. Commissioner*, 126 F. 2d 570 (C. C. A. 5th); *Alpers v. Commissioner*, 126 F. 2d 58 (C. C. A. 2d); *Amelia H. Cohen Trust v. Commissioner*, 121 F. 2d 689 (C. C. A. 3d); *Hammans v. Commissioner*, 121 F. 2d 4 (C. C. A. 2d); *Commissioner v. Quackenbos*, 78 F. 2d 156 (C. C. A. 2d); *Mittelman v. Commissioner*, 5 T. C. 932, 939-940; *Allport v. Commissioner*, 4 T. C. 401, 403, dismissed and affirmed January 29, 1946 (C. C. A. 7th); *Irvine v. Commissioner*, 46 B. T. A. 246; *Britt v. Commissioner*, 40 B. T. A. 790, 795-796, affirmed on other grounds, 114 F. 2d 10 (C. C. A. 4th); *Salt Lake Hardware Co. v. Commissioner*, 27 B. T. A. 482. See, also, 1 Mertens, *Law of Federal Income Taxation*, Section 9.83.² Cf. *Thornton v. Commissioner*, decided January 31, 1947 (C. C. A. 7th) (1947 P-H, par. 72,357).

² *Beretta v. Commissioner*, 141 F. 2d 452 (C. C. A. 5th), certiorari denied, 323 U. S. 720, contains language suggesting that an intention to liquidate corporate business is required to make a distribution one in partial liquidation within the meaning of the first definition in Section 115 (i). This view is not consistent with other decisions of the same court, cited above. The *Beretta* opinion cited *Bynum v. Commissioner*, 113 F. 2d 1 (C. C. A. 5th), as support for the view there taken, but the *Bynum* case was not apposite, since it was not concerned with the first definition of partial liquidation in Sec-

As indicated, the taxpayer argues (Pet. 13-16) that the transaction should be treated as a complete liquidation on the basis of what she conceives the intention of the parties to have been. The meaning of the term "complete liquidation," for purposes of taxing the gain on a distribution in complete liquidation, is defined in Section 115 (c) (Appendix, *infra*), and the procedure followed here does not fall within that definition. Moreover, the Tax Court found (R. 27) that the stockholders did not intend to effect a complete liquidation of the corporation and the record fully supports that determination. The Austin estate expressly refused to liquidate the corporation and distribute all its assets. Instead, it redrafted the contract, which taxpayer signed, to provide for only a partial distribution of assets in cancellation of part of the stock. (R. 20.) The final agreement reflects the stockholders' intention. The decision of the court below does not deny that the purpose of the stockholders was to divide completely the corporate assets; it merely declares that the method employed to achieve the purpose

tion 115 (i), but solely with the second definition, in connection with which an intention to liquidate may be pertinent to show that a particular distribution is one of a series in complete cancellation of all the stock. The *Beretta* case, however, correctly decided that there was no partial liquidation in that case, as first defined in Section 115 (i), because there was not a complete cancellation of any part of the stock, but only a reduction in par value of all of the stock.

conformed to the statutory definition of a partial liquidation, rather than that of a complete liquidation.

There is, likewise, no basis for the view that the substance of the transaction was different from its form (Pet. 16-20). None of the cases cited by taxpayer (Pet. 17) are apposite to the facts here. In this case the form selected fully carried out the purposes of the taxpayer and the Austin estate as reflected in their agreement and in the resolutions adopted by the corporation. The fact that the taxpayer, alone of the two stockholders, would have preferred to divide the corporation's assets through the mechanics of a complete liquidation does not demonstrate that the partial liquidation agreed upon amounted in substance to a complete liquidation. Also, since the corporation and its stockholders elected to complete the transaction as a partial liquidation, they are bound to accept the tax consequences of the plan. See *Higgins v. Smith*, 308 U. S. 473, 477-478; *Commissioner v. Moline Properties*, 131 F. 2d 388, 389 (C. C. A. 5th), affirmed, 319 U. S. 436.

(2) Since the distribution to the taxpayer was an amount distributed in partial liquidation as defined in Section 115 (i), it is, as the lower court held, subject to be taxed as provided in Section 115 (c). That is, the lands received by taxpayer are to be treated as received in exchange for the stock surrendered, and the gain thereon

to the extent recognized³ is to be considered as a short-term capital gain (defined in Section 117 (a) (2) (Appendix, *infra*)) with the result that all of it is to be included in gross income under Section 117 (b) (Appendix, *infra*). All of the cases have construed the language of Section 115 (c) as conclusive that the gain on any distribution in partial liquidation, made prior to 1942, is taxable in its entirety.⁴ See, also, Section 19.115-5 (c) of Treasury Regulations 103 (Appendix, *infra*).

The taxpayer's assertion (Pet. 11-13) that this provision of Section 115 (c) was intended to apply, not to *bona fide* cancellations of stock, but solely to distributions of earnings disguised as liquidating distributions, was properly rejected by the lower court.⁵ Section 115 (g), rather than Section 115 (c), is the section which is concerned specifically with distributions of earnings in can-

³ There is no dispute as to the computation of the gain under Section 111 or that all of it is to be recognized under Section 112 (a). The taxpayer's agreed basis for the stock was \$2,750 (R. 18) and the fair market value of the lands received was \$87,802 $\frac{1}{2}$ (R. 22). Her gain was thus \$85,052.

⁴ *Stern v. Harrison*, 152 F. 2d 321 (C. C. A. 7th), certiorari denied, 327 U. S. 807; *Yankey v. Commissioner*, 151 F. 2d 650 (C. C. A. 10th); *Malone v. Commissioner*, 128 F. 2d 967 (C. C. A. 5th); *Hill v. Commissioner*, 126 F. 2d 570 (C. C. A. 5th); *Amelia H. Cyphen Trust v. Commissioner*, 121 F. 2d 689 (C. C. A. 3d); *Hammans v. Commissioner*, 121 F. 2d 4 (C. C. A. 2d).

⁵ *Thornton v. Commissioner*, decided January 31, 1947 (C. C. A. 7th) (1947 P-H ¶ 72,357) contains language which would appear to afford some basis for this assertion. Examination of the opinion indicates that the statement is dictum and that the decision is based on a strict construction of the language of the statute.

cellation of stock, which are essentially equivalent to a taxable dividend. The contention, moreover, is contrary to the unambiguous language of Section 115 (c), to the regulation, to express rulings in *Stern v. Harrison*, *supra*, and *Hammons v. Commissioner*, *supra*, to the reasoning of the other decisions cited in footnote 4, *supra*, and to statements in H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 49, 93 (1942-2 Cum. Bull. 372, 412, 442-443) and S. Rep. No. 1631, 77th Cong., 2d Sess., p. 116 (1942-2 Cum. Bull. 504, 591), which explain the non-retroactive repeal of Section 115 (c) by Section 147 of the Revenue Act of 1942, c. 619, 56 Stat. 798, as designed to correct inequities, pointing out that under "existing law" gains on distributions in partial liquidation were taxed as short-term capital gains, irrespective of the period the stock was actually held.⁶

Finally, equitable considerations (see Pet. 10-11, 16) would not have justified a construction of the statutory provisions controlling the taxation of the distribution which was directly opposed to, or inconsistent with, the plain meaning of the language used. *Deputy v. du Pont*, 308

⁶ The effect of the 1942 change is that gains on distributions in partial liquidation made in 1942 and subsequent years are treated as are other capital gains. The amount of the gain which is taxable is determined by the period the surrendered stock has been held. Thus, a gain is included in income in its entirety only if the cancelled or redeemed stock has actually been held for the period to qualify it as a short-term capital asset as defined in the Internal Revenue Code.

U. S. 488, 498; *United States v. Emory*, 314 U. S. 423, 430-431.⁷ This is particularly true where, as here, Congress itself has declined to change the method of taxing distributions in partial liquidation, except for 1942 and subsequent years, despite the recognized inequities in existing law.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MARCH, 1947.

⁷ *Stone v. White*, 301 U. S. 532, cited by the taxpayer (Pet. 10), was concerned with the equitable right of set-off in a suit to recover an erroneously paid tax, a wholly different question from that here.

APPENDIX

Internal Revenue Code:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * * *

(c) *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117, the gain so recognized shall be considered as a short-term capital gain, except in the case of amounts distributed in complete liquidation. For the purpose of the preceding sentence, “complete liquidation” includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding, from the close of the taxable year during which is made the first of the series of distributions under the plan, (1) three years, if the first of such series of distributions is made in a taxable year beginning after December 31, 1937, or (2) two years,

if the first of such series of distributions was made in a taxable year beginning before January 1, 1938. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits.* * *

(i) *Definition of Partial Liquidation.*—

As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

(26 U. S. C. 115.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(2) *Short-term Capital Gain.*—The term "short-term capital gain" means gain from the sale or exchange of a capital asset held for not more than 18 months, if and to the extent such gain is taken into account in computing net income;

(b) *Percentage Taken into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or

exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 18 months;
 66 $\frac{2}{3}$ per centum if the capital asset has been held for more than 18 months but not for more than 24 months;
 50 per centum if the capital assets has been held for more than 24 months.

* * * * *

(26 U. S. C. 117.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.115-5. *Distributions in liquidation.*—

(a) *General.*—Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation are to be treated as in part or full payment in exchange for the stock so cancelled or redeemed. The gain or loss to a shareholder from a distribution in liquidation is to be determined, as provided in section 111 and section 19.111-1, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 113; but the gain or loss will be recognized only to the extent provided in section 112.

* * * * *

(c) *Partial liquidation.*—In the case of amounts distributed in partial liquidation of a corporation, the amount of the loss recognized is subject to the limitations contained in section 117 but the entire amount of the gain recognized shall be considered as a short-term capital gain despite the provi-

sions of section 117.* The term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock. A complete cancellation or redemption of a part of the corporate stock may be accomplished, for example, by the complete retirement of all the shares of a particular preference or series, or by taking up all the old shares of a particular preference or series and issuing new shares to replace a portion thereof, or by the complete retirement of any part of the stock, whether or not pro rata among the shareholders.

* * * * *

*This sentence was amended by T. D. 5230, 1943 Cum. Bull. 299, 308, to conform it to the provisions of the Revenue Act of 1942, but the amendment does not affect the year involved in this case.